Archive

Articles for the Month:

Samuel Brittan

makes the case for benign neglect of the US dollar and points to research from Smithers and Co suggesting that the US current account deficit should arguably be wider: *According to conventional wisdom the weakness of the dollar reflects an excessive US current account deficit of 5½ per cent of GDP. This conventional wisdom reflects an outdated preoccupation with the current account which ignores offsetting capital movements. The financial firm, Smithers, suggests however that the deficit is too low rather than too high because of the greater likely return on capital in the US than Europe or Japan. On modest assumptions about differential economic growth, it argues, the proportion of US assets owned by foreigners would only be 15 per cent five years from now and never rise above one third, even if such a deficit had to be financed indefinitely.* The 'consenting adults' view of current account deficits is now widely accepted by policymakers in Australia and has been associated with a significant improvement in macro policy outcomes compared to previous decades, when the current account balance was a preoccupation of policy. As Brittan argues, when the current account and exchange rates become a focus for policy, the consequences are usually far more destabilising than anything that would be produced by market-determined exchange rates: *Nothing will prevent jerky readjustments in the real world; but inevitable fluctuations are made a great deal worse by the efforts of governments to orchestrate the pace of change.*

posted on 1/30/2004

What I am reading.

Alex Kerr's *Dogs and Demons: The Fall of Modern Japan* in many ways picks up where Karel van Wolferen's *The Enigma of Japanese Power* left off and Kerr acknowledges his debt to van Wolferen, who was notable for highlighting the dysfunctional nature of the Japanese state at the height of the late 1980s boom. What makes Kerr's book distinctive is his particular concern with the state-sponsored vandalism of Japan's natural environment and its architectural and cultural heritage. Kerr is not an economist but clearly recognises the role of institutionalised rent-seeking and peverse economic incentives in the ruin of modern Japan. There is a particularly pleasing chapter on Japan's disastrous neglect of service industries such as tourism in favour of manufacturing. State-mandated privileging of manufacturing over service industries is hardly unique to Japan. These ideas remain a hardy perennial outside Japan and have been a solid staple of management and business education, not least in Australia. Yet in Japan we can see many of these ideas taken to their logical and disastrous extremes. Those who advocate high levels of state-sponsored national saving, government support for preferred technologies and manufacturing industries and heavy public investment in infrastructure often accuse their critics of being overly wedded to neo-classical theory, yet it is the practice that is more damning than the theory. Kerr's focus on the implications of these policies for the grim realities of everyday Japanese life is what makes this book so compelling. Kerr is sometimes overly quick to make unfavourable comparisons with the rest of East Asia, even though the whole region shares many of the problems he identifies in Japan. For example, he argues that 'the drive from Changi airport into downtown Sinagpore is one of the pleasures of the modern world.' High praise indeed for what in reality is a thinly disguised runway built to military specifications!

posted on 1/26/2004

Institutional Economics Turns One.
Institutional Economics was launched a year ago today, coinciding with my departure from financial markets to return to academia. It has been a rewarding experience, with the site collecting a number of gongs and traffic peaking at over 9,000 page views per week. This is modest compared to many other blogs, but still exceeded my expectations given the somewhat specialised nature of the content. Most of my readers come from outside Australia, despite the inevitable Australian focus in my blogging. The globalisation of intellectual life via the internet in general, and blogs in particular, is something I find extremely interesting and it has been great playing a modest role in that process. My not so modest role in blowing the whistle on Paul Krugman's UK publishers over their use of the imagery of the anti-globalisation left to market his latest book is a good example. Bloggers have a potentially important role in promoting accountability across a wide range of institutions and I would encourage people with specialised knowledge in any field to make a contribution in this way. The rewards from blogging are largely non-pecuniary, but it is also pleasing to note that many of you have put aside the obvious free-rider issues and made donations to this site, either directly or through the associate links (a way of donating that costs you nothing). A big 'thank you' to those who contributed. I am still thinking of ways to provide exclusive benefits to donors. One option is a donor-only newsletter along the lines of Andrew Sullivan's Inside Dish, but I need more expressions of interest to make this a worthwhile venture. If this is something that would interest you, and you have not previously expressed your interest, hit the tip jar. I will be taking a break over the next couple of weeks, during which blogging will be light at best. But you can find plenty of reading at some of my favourite blogs: Marginal Revolution, Dan Drezner, Knowledge Problem and Catallaxy Files.

posted on 1/17/2004

Japanese exports to mainland China, Hong Kong and Taiwan
in 2003 are estimated to have exceeded those to the U.S. for the first time:
According to Ministry of Finance trade figures, the balance of exports to China, Hong Kong and Taiwan for the first 11 months of 2003 totaled 12.34 trillion yen, up 19.5% over the same period the previous year, while exports to the U. S. were 12.29 trillion yen. Goods shipped to those three regions outpaced exports to the U.S. for the first time in March, and they have collectively held the top position in the export market for the six months since June.

posted on 1/17/2004

The threshold for Foreign Investment Review Board scrutiny may be raised as part of the Australia-US FTA currently being negotiated. This is not exactly news, but the Minister has been addressing the issue in public comments: *Australia's 30-year-old foreign investment regime faces a major overhaul in last-minute negotiations over a US free-trade deal that are due to resume next week. Australian companies have already backed a big increase in the threshold for foreign investment regulation, and Trade Minister Mark Vaile yesterday gave a strong indication that changes would be made. "The Americans are looking for better access to Australia as an investment destination ... and I think that, to the situation we are in now as an economy, we want foreign investment in Australia," Mr Vaile said. Under the foreign investment regulation regime adopted in the 1970s, the Australian government has the power to reject investments as not in the national interest above a threshold that now ranges between $10 million and $50 million, depending on the type of investment. US negotiators want Australia to change the national interest veto to the narrower US-style approach that provides for a national security veto instead. Corporate Australia has also backed changes to the rules, saying the current threshold - which limits the amount foreign companies can invest before they have to seek Treasury approval - should be raised as much as tenfold to $500 million. Mr Vaile said: "We're having a look at all aspects of it, and it's an area where the critical element of FIRB scrutiny is being able to look after the national interest, both in terms of a broader security sense and an economic security sense." But he indicated that even if the threshold was changed, Australia wanted to retain some right to look at investments it deemed harmful.* Australia runs the fifth most restrictive foreign investment regime in the OECD and cross-border direct investment is subject to arbitrary ministerial veto on nebulous 'national interest' grounds, often at the behest of sectional interests. It remains to be seen whether the FTA can produce a more rule-bound regime for foreign direct investment in Australia. The US is the largest foreign investor in Australia, but less well known is the fact that Australia is one of the largest investors in the US (Australia has become a net exporter of direct investment capital in recent years). There would be justifiable outrage if Australia's investment abroad were subject to the sort of arbitrary regulatory framework Australia currently imposes on prospective foreign investors.

posted on 1/16/2004

Free Trade Watch.
Ryan Lizza's new campaign blog notes that free trade has become a dirty word among Democrats. At the same time, Australia's Federal opposition leader, Mark Latham, is backing away from his earlier support for free trade. Yet Andrew Norton notes a suprising amount of popular support for an Australia-US Free Trade Agreement.

posted on 1/15/2004

Marginal Revolution
links to this survey of the labour market for new PhD hires in economics. The good news (for me at least) is that macro/monetary economists are in demand.

posted on 1/13/2004

Henry Ergas

of NECG argues that the biggest threat to the Australian Competition and Consumer Commission’s informal merger review process is the ACCC’s failure to adhere to its own guidelines: *However, for an informal process to work the ACCC needs to stick to its side of the bargain. In the AGL case it didn't. No one needs to tell the ACCC how to make the informal process work - given the commission's years of experience, it well knows how. Indeed, the commission's merger guidelines are exemplary in setting out an analytical framework and methodology for the assessment of proposed mergers. Of course, there is room for improvements, for example, in terms of disclosing more fully the reasons for decisions. But those improvements could be made without undermining the basic features of the merger control mechanism as it has operated to date. Whether this occurs is now up to the ACCC. Blaming the victim will do little good. Rather, if the new team at the ACCC wants to preserve the informal process, it needs to renew its commitment to a process that, though informal, is predictable and timely, and implemented in a manner strictly consistent with the commission's own merger guidelines. If it fails to do so, then it can hardly be surprised if ever-stronger pressures develop for a more formal alternative.* Unfortunately, the main reason the ACCC prefers an informal process is precisely so that it can bend the rules. The ACCC’s opposition to a more formal process is about preserving its bureaucratic discretion.

posted on 1/12/2004

That Krugman cover again.

The ever-expanding genre of anti-Bush diatribes is the subject of a review in *The Economist*: *Yet Bush hatred arguably now exceeds even Clinton hatred in its scope. It has become a genre with endless sub-genres…More important, Bush hatred is multinational. Clintophobia largely stopped at America's borders. But Bush loathing has picked up a strong anti-American tailwind, one that the loathers are not unafraid to exploit. The cover for the American edition of Paul Krugman's collection of anti-Bush essays, “The Great Unravelling”, is fairly restrained; the British cover is a grotesque lobotomised image of the president and vice-president which would horrify readers of Mr Krugman's column in the New York Times. As a commercial phenomenon, Bush hatred is rather interesting. But sooner or later, you have to look at the content—and this is depressing, particularly if you read more than one book. Most of the anti-Bush books are fairly lazy affairs, endlessly repeating the same old stories.* Although Krugman's latest is not actually a subject of the review, it is interesting that the book's cover has landed him a mention in a review of Michael Moore, Al Franken et al. The reviewer also notes with some sadness that he is compelled to include Kevin Phillips in this genre. Good people fallen in bad company care of Bush Derangement Syndrome.

posted on 1/11/2004

The Australian Financial Review
headlines 'IMF lashes Bush over soaring budget deficit.' Here is Charles Collyns, Deputy Director of the IMF's Western Hemisphere Department, introducing the report: *Summing up, the recent expansionary stance of the U. S. fiscal policy has certainly been beneficial, supporting the global economy at a difficult juncture. However, it will be important to develop a credible and robust framework to assure that the U.S. fiscal position is a strong one over the long run. This will require determined action to reduce the federal deficit over the next 5 to 10 years and to tackle the difficult long-term problems of Social Security and Medicare.* Always pays to read beyond the headline spin.

posted on 1/9/2004

Jagdish Bhagwati's
credentials as a free trader have long been compromised by his hostility to the free movement of capital. He is not alone in this. Many of the most passionate advocates of free trade in goods and services adopt a completely contrary stance when it comes to capital and labour. This is especially unfortunate in the case of Bhagwati, because he is still one of the most prominent advocates of globalization, most notably with his recent book, *In Defence of Globalisation*. Richard Cooper's review highlights some of the weaknesses in Bhagwati's arguments on these issues: *Bhagwati is less keen on the free movement of capital across national borders. He attributes the financial meltdowns of the 1990s to a "Wall Street-Treasury Complex" that pressured developing countries to liberalise capital flows. His discussion of financial crises, however, is uncharacteristically sloppy and naive. Although Washington did fight for capital liberalisation (and misguidedly continues to do so in bilateral trade negotiations), other countries can resist if it goes against their interests (as both Singapore and Chile did successfully). There was also tremendous variation among the countries that suffered crises, which Bhagwati's simplistic account overlooks. Indonesia had accepted the free movement of capital more than 20 years prior to its financial meltdown. Thailand and South Korea accepted only limited capital liberalisation in the early 1990s and carried it out in ways that clearly invited trouble. Brazil and Russia maintained some capital controls throughout (although not on foreign purchases of government securities), but such measures offered little protection. And Malaysia's much-touted restrictions on foreign capital flight were not introduced until a year after the crisis broke and thus do not explain that country's shallower recession, as critics of capital liberalisation often claim. A look at history reveals that financial crises are not unique to the 1990s. In the 19th century, long before the US Treasury and the International Monetary Fund became influential on the international stage, rapidly growing countries - the UK, France, and the US, the developing nations of the day - experienced financial crises at least once a decade. Successful industrialists and financiers, caught up in the euphoria of growth and unimpeded by regulation, drove a dramatic boom-and-bust cycle. That pattern has repeated again and again and seems to be an inherent part of development. If there is any lesson here, it is that governments should learn more from the unpleasant experiences of other countries in other times. Spouting facile criticism of globalisation is easy, especially when unconstrained by fact, and so is refuting it. Bhagwati's defence of globalisation is persuasive. He is less successful, however, in his attempt to offer feasible policy alternatives that are likely to improve on existing arrangements. He suggests that the World Bank finance*

adjustment assistance with respect to trade liberalisation in developing countries, showing no awareness that the World Bank must borrow most of its funds in capital markets at market interest rates (and hence must be repaid by its borrowers) or that adjustment assistance has worked poorly in the US. He suggests a retroactive tax on carbon dioxide emissions over the past century, the proceeds of which would go to help developing countries reduce their own greenhouse gas emissions. He recommends that multinational corporations operating in developing countries follow the same labour and environmental standards as they do at home, without acknowledging that such advice may contradict local law and could discourage some multinationals from expanding to developing countries, thus denying them the many benefits, well expounded by Bhagwati, that foreign companies can bring.

posted on 1/9/2004

A Tale of Two Current Account Deficits.

This blog has been dismissive of much of the alarmist writing about the US current account deficit and the USD over the last year. My attitude to this is heavily conditioned by the fact that I live in a country where large cyclical swings in the current account balance and currency are the norm and which, not coincidentally, has had one of the strongest growth rates in the OECD in the 1990s. Tony Makin, one of my favourite economists, also compares the US and Australia in an op-ed: *So why is the local dollar so strong when Australia's current account deficit is actually bigger than that of the US? In fact, Australia has a current account deficit of 5.8 per cent of its gross domestic product, significantly above the US deficit and still one of the largest in the world. Canberra, we have a conundrum. What deepens the mystery is the fact that Australia's foreign debt, the consequence of past external deficits, is also much higher than that of the US as a proportion of GDP. Not only that, but a large part of Australia's foreign debt is in foreign currency, whereas US foreign debt is in its own currency. This means US borrowers bear next to no foreign exchange risk on foreign loans, unlike many of their Australian counterparts. Australia's current account deficit is of course the same one that was a prime focus of macroeconomic policy attention over most of the 20 years since the float of the Australian dollar. Indeed, at times, it was the only focus. In the past, external deficits of the present size were used to justify many policy sins, most notably the major monetary policy-induced recession we supposedly had to have in the early 1990s. This recession was essentially caused by a misunderstanding of what the current account deficit signified.* Makin blames the US budget deficit for USD weakness and suggests the following policy prescription for Australia: *Meanwhile, to alleviate the present squeeze on the tradeable goods sector of the Australian economy, the federal Government could well follow the US fiscal example. Cut income taxes, run a budget deficit and watch our dollar fall.* Of course, the politics of fiscal policy in Australia would rule out any such policy. But it is welcome to see someone thinking about fiscal policy outside the narrow confines of the budget surplus.

posted on 1/7/2004

Alan Greenspan

reassuringly rejects the idea that central banks should target asset price inflation: *It is far from obvious that bubbles, even if identified early, can be preempted at lower cost than a substantial economic contraction and possible financial destabilization--the very outcomes we would be seeking to avoid... The notion that a well-timed incremental tightening could have been calibrated to prevent the late 1990s bubble while preserving economic stability is almost surely an illusion.* However, Greenspan continues to defend what he calls the 'risk management' approach to monetary policy, a euphemism for the almost unbounded discretion of the Fed. But as Greenspan himself notes: *rules that relate the setting of the federal funds rate to the deviations of output and inflation from their respective targets, in some configurations, do seem to capture the broad contours of what we did over the past decade and a half.* Since such rules usually incorporate an assumed inflation target, it would make sense for the Fed to formalise this implicit target in its policymaking. At the same time, FRB Governor Bernanke has been talking on the subject of 'Fedspeak.' The Fed's communication with the public was widely criticised last year. One of the advantages of adopting a more rule-bound approach to the conduct of monetary policy would be to greatly simplify the Fed's communication with the public. Under a regime of unbounded discretion, the public can be forgiven for over or misinterpreting the statements of Fed officials, since these statements are the only real guide to the Fed's intentions apart from the actual policy decisions themselves.

posted on 1/5/2004

Richard Rahn

joins the ranks of US dollar alarmists: *A continued drop in the dollar's value could destabilize the international economy, leading to a worldwide recession.* Rahn's column evinces little faith in market-determined exchange rates. His claim that the US is discouraging foreign investors may well be true, but we do not need to speculate about the exchange rate implications of this to make an argument for freeing up foreign investment. Rahn argues that the US should reaffirm 'belief in a strong dollar.' But if this is not to be an empty rhetorical position, then Rahn is effectively arguing for either foreign exchange market intervention or some combination of monetary tightening and fiscal easing designed to support the dollar. These discretionary macro policy interventions have the potential to be far more destabilising than movements in market-determined exchange rates. There has always been some tension in classical liberal circles between those who argue for market-determined foreign exchange rates and those who still view foreign exchange rates through the prism of various hard-money doctrines. Rahn claims that 'to grow, the world economy needs reasonable currency stability.' But it is remarkable how resilient the real economy is to exchange rate volatility. Flexible exchange rates have a valuable role to play in clearing world markets for goods, services and capital and insulating economies against external shocks. This is true not just for small open economies likely Australia, but also large, relatively closed economies such as the US.

posted on 1/3/2004